

Long Association of Senior Personnel (Including Partner Rotation) with an Audit Client—Matters for Consideration

Background

1. Paragraph 290.150 of the IESBA *Code of Ethics for Professional Accountants* (the Code) states that familiarity and self-interest threats are created by using the same senior personnel on an audit engagement over a long period of time. Paragraph 290.151 provides that for public interest entities that are audit clients, the key audit partner should be rotated after having served for seven years and, upon being rotating off the engagement, shall not be a member of the engagement team or be a key audit partner for the client for two years.
2. The Code defines a “key audit partner” as:

The engagement partner, the individual responsible for the engagement quality control review, and other audit partners, if any, on the engagement team who make key decisions or judgments on significant matters with respect to the audit of the financial statements on which the firm will express an opinion. Depending upon the circumstances and the role of the individuals on the audit, “other audit partners” may include, for example, audit partners responsible for significant subsidiaries or divisions.
3. Setting aside the partner rotation requirements in the Code, several jurisdictions have additional or different requirements relating to partner rotation on listed entity or other public interest entity audit engagements.
4. In December 2012, the IESBA approved this project to consider whether the long association provisions in the Code as a whole remain appropriate, with a specific focus on the rotation requirements for key audit partners for audits of PIEs.
5. It was agreed that the Task Force should commence research, having regard to the specific matters that were identified in the project proposal for consideration in this project, in addition to the rotation requirements for key audit partners, i.e.:
 - Whether a shorter period on the engagement team and/or a longer time-out period would strengthen auditor independence and, if so, how such a change could operate in a global code.
 - The types of entities with respect to which rotation requirements should apply (e.g., all PIEs or other entities according to industry, size, or market characteristics).
 - The partners covered in the definition of key audit partners.
 - Whether the PIE rotation requirements should apply to other individuals involved in the audit in addition to key audit partners.
 - The implications of any relationship between the individual rotating off the engagement and that individual’s replacement;
 - The nature of the involvement, if any, that the rotated individual may have in the audit while rotated off.
 - Any specific exemptions that should be provided.

- Whether those charged with governance should be involved in the rotation decision and, if so, how and to what extent.
6. Not included in the scope of the project is the matter of mandatory firm rotation, on which the IESBA agreed to keep a watching brief.

Benchmarking Survey

7. The Task Force agreed that it is important to have a thorough understanding of partner rotation provisions in a range of jurisdictions. It also decided that the research undertaken should be broad and not be restricted to major capital markets. Therefore, leveraging connections within the Task Force, a survey developed by the Task Force was distributed to two of the large firms¹ as an efficient way to collect information about the partner rotation provisions in a number of jurisdictions in which the firms operate. Approximately 90 responses have been received to date, which will require significant resources and time to analyze. The Task Force plans to present an analysis of the survey responses to the Board at its June 2013 meeting.
8. A copy of the survey is attached as Appendix 1.
9. Agenda Item G-3 shows the jurisdictions with respect to which a survey response has been received.

Audit Committee Research

10. At the December 2012 IESBA meeting, it was suggested that it may be helpful to consult with audit committees to identify the factors that they use to evaluate the objectivity of the auditor. The Task Force therefore proposes to undertake a survey of audit committees, similar to the survey undertaken for the Breaches project. The proposed survey is included in Appendix 2.
11. The Task Force will aim for a broad cross section of respondents and will leverage available contacts to obtain input from diverse jurisdictions. A distribution approach similar to that used for Breaches will be employed, for example, utilizing an electronic survey tool, highlighting the survey in the IESBA e-News and in the IFAC newsletter, seeking Board participants' assistance in promoting it to audit committee contacts in their jurisdictions, etc.
12. Subject to the IESBA's concurrence, the Task Force anticipates undertaking the survey from the end of Q1 and into Q2 2013.
13. As a supplementary research effort, the Task Force could undertake a review of guidance provided to audit committees by their representative bodies or regulators.

Regulator Research

14. It was also suggested at the December 2012 IESBA meeting that it would be useful to understand regulators' views, in particular why they chose the rotation requirements that apply in their jurisdictions. The Task Force therefore plans to seek, as part of the proposed research, the views of regulators who have responsibility for setting those requirements as well as the views of audit and other regulators, such as those in the banking and insurance fields. The Task Force plans to obtain this input via:

¹ Deloitte and PwC

- The benchmarking survey referred to in paragraphs 7-9 above.
 - The IESBA Consultative Advisory Group (CAG)
 - The IESBA-National Standard Setters (NSS) liaison group.
 - Inspection and other reports by IFIAR members.
15. In December 2006, the IESBA issued an exposure draft on the topic of independence that considered the long association provisions in the Code. The Task Force will review the responses of regulators to that exposure draft to the extent that these remain relevant.
16. The benchmarking survey includes a question on the views of regulators:
- In relation to questions 1-3, as appropriate, can you provide any comments regarding the rationale for having additional or different audit partner rotation requirements in your jurisdiction?
- Are you are aware of any impending changes in audit partner rotation requirements in your jurisdiction?
17. Views of CAG and NSS representatives will be sought at the upcoming CAG and NSS meetings in April and May 2013, respectively, likely on the same matters included in the proposed survey of audit committees.
18. The work of the International Forum of Independent Audit Regulators (IFIAR) has included audit inspection reports for some jurisdictions. Desk research has identified comments pertaining to the matter of long association in reports from the following jurisdictions:
- Australia (2011/12)
 - Germany (2007/10)
 - Malaysia (2011)
 - Netherlands (2011)
19. The Task Force will consider whether these reports provide insights into the impact of partner rotation rules vis-à-vis independence. It is noted that the rules in some IFIAR members' jurisdictions are not the same as those in the Code.

Firm Research

20. The Task Force plans to research firms' views on the impact of possible changes to the current long association provisions, the challenges that firms are facing with the current provisions, the effectiveness of rotation in reducing concerns about independence, and the impact of the timing for the implementation of any changes. The Task Force plans to invite views of the larger firms through the members of the IESBA, and to obtain the views of a sample of SMPs through the IFAC SMP Committee.

Academic Research on Long Association

21. Staff has conducted an initial desk review of academic research into the topic of long association. The Task Force will review the research for matters of relevance to the project. A summary of the research will be provided to the Board if it is judged relevant.

Limited Resource Exemption, and SMPs

22. Paragraph 290.155 sets out the limited resource exemption as follows:

When a firm has only a few people with the necessary knowledge and experience to serve as a key audit partner on the audit of a public interest entity, rotation of key audit partners may not be an available safeguard. If an independent regulator in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may remain a key audit partner for more than seven years, in accordance with such regulation, provided that the independent regulator has specified alternative safeguards which are applied, such as a regular independent external review.

23. When the IESBA consulted on revisions to the Code in 2006, it noted that many comments were received regarding the need for an exemption with respect to the circumstance where a firm has only a few people with the necessary knowledge and experience to serve as a key audit partner. Given the importance of this provision, it was noted at the December 2012 IESBA meeting that it would be helpful for the research to consider the impact of the provision and how practice may have evolved.

24. A question on exemptions was included in the benchmarking survey. Staff has approached the IFAC SMP Committee staff for assistance in obtaining information with regard to the SMP community that may be necessary to supplement the results of the benchmarking survey. The Task Force notes that this exemption may be relevant in small firms that are members of the larger firm networks and they too may have views on the exemptions in the Code.

Project Timeline

25. The Task Force anticipates that the forward timeline will be as follows, subject to the progress of the research. This timeline assumes that changes to the Code will be proposed, requiring issuance of an exposure draft. The Task Force would ideally wish to issue the exposure draft after the March 2014 IESBA meeting, subject to obtaining the CAG’s input on the proposals.

| Time | Activity |
|-------------|-------------------------------------|
| Q1-Q2 2013 | Survey of jurisdictions |
| March 2013 | Status Report to IESBA |
| April 2013 | CAG meeting |
| | Analysis of jurisdiction survey |
| | Survey of Audit Committees |
| May 2013 | NSS meeting |
| June 2013 | Jurisdiction survey report to IESBA |
| | Analysis of Audit Committee surveys |

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IESBA CAG Meeting (April 2013)

| Time | Activity |
|-------------|---|
| Sept 2013 | Report on research to CAG |
| Sept 2013 | Report on research to IESBA, with preliminary recommendations |
| | Drafting of proposed changes to the Code |
| Dec 2013 | First read of proposed changes to the Code |
| Q1 2014 | Consultation with CAG |
| March 2014 | IESBA approval of exposure draft |

Survey of Audit Partner Rotation Requirements in a Range of Jurisdictions

Survey: Audit partner rotation requirements

JURISDICTION:

[insert jurisdiction]

Q1

IESBA CODE ROTATION REQUIREMENTS - PUBLIC INTEREST ENTITIES

290.151 provides: "In respect of an audit of a public interest entity, an individual shall not be a key audit partner for more than seven years. After such time, the individual shall not be a member of the engagement team or be a key audit partner for the client for two years. During that period, the individual shall not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events or otherwise directly influence the outcome of the engagement."

290.152 provides: "Despite paragraph 290.151, key audit partners whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the firm's control, be permitted an additional year on the audit team as long as the threat to independence can be eliminated or reduced to an acceptable level by applying safeguards. For example, a key audit partner may remain on the audit team for up to one additional year in circumstances where, due to unforeseen events, a required rotation was not possible, as might be the case due to serious illness of the intended engagement partner."

290.153 requires that any threats to independence related to the long association of other partners be evaluated.

Q1: Are there any local professional or regulatory audit partner rotation requirements in your jurisdiction that are additional to, or different from, these IESBA Code requirements?

[YES / NO]

If YES, please complete the table below as comprehensively as possible with all the requirements in your jurisdiction. Add as many types of personnel/entities as needed.

| CURRENT REQUIREMENTS | Type of entity | Definitions (add in notes below) | Relevant Regulation or Code name | Years of service permitted | Years "cooling off" | Exceptions or conditions |
|--|----------------|----------------------------------|----------------------------------|----------------------------|---------------------|--------------------------|
| Lead audit engagement partner | Listed entity | | | | | |
| EQCR partner | Listed entity | | | | | |
| Other key audit partner | Listed entity | A | | | | |
| Other audit partner | Listed entity | B | | | | |
| Other senior personnel (manager level) | Listed entity | C | | | | |
| Other audit engagement staff | Listed entity | D | | | | |
| Lead audit engagement partner | Other PIE | E | | | | |
| EQCR partner | Other PIE | | | | | |
| Other key audit partner | Other PIE | | | | | |
| Other audit partner | Other PIE | | | | | |
| Other senior personnel (manager level) | Other PIE | | | | | |
| Other audit engagement staff | Other PIE | | | | | |
| Lead audit engagement partner | [Other?] | F | | | | |
| EQCR partner | [Other?] | | | | | |
| Other key audit partner | [Other?] | | | | | |
| Other audit partner | [Other?] | | | | | |
| Other senior personnel (manager level) | [Other?] | | | | | |
| Other audit engagement staff | [Other?] | | | | | |

Long Association – Matters for Consideration
 IESBA CAG Meeting (April 2013)

| NOTES: Add relevant definitions/detail here (as necessary) | |
|--|--|
| A. Key audit partner | |
| B. Other audit partner | |
| C. Other senior personnel | |
| D. Other audit engagement staff | |
| E. Public Interest Entity | |
| F. Other type of entity to which rotation applies | |

| | | |
|-----------|---|-------------|
| Q2 | Q2: With respect to the role of the individual in the "cooling off" period (290.151), does your jurisdiction have any additional or different requirements or guidance on the nature of the involvement, if any, that the rotated individual may have in the audit or with the client while rotated off? If yes, please provide details. | [YES / NO] |
| | | |

| | | |
|-----------|--|-------------|
| Q3 | Q3: Does your jurisdiction have any additional requirements or guidance on the implications of any relationship between the individual rotating off the engagement and that individual's replacement? If yes, please provide details. | [YES / NO] |
| | | |

| | | |
|-----------|---|-----------------|
| Q4 | Q4: In relation to questions 1-3, as appropriate, can you provide any comments regarding the rationale for having additional or different audit partner rotation requirements in your jurisdiction? If yes, please provide details and any information that would be helpful for understanding the regulator's/standard setter's rationale for having stricter or different requirements than the IESBA Code | [YES / NO/ N/A] |
| | | |

| | | |
|--|--|-------------|
| Q5 | IESBA CODE ROTATION REQUIREMENTS - LIMITED EXEMPTION | |
| 290.155 provides: "When a firm has only a few people with the necessary knowledge and experience to serve as a key audit partner on the audit of a public interest entity, rotation of key audit partners may not be an available safeguard. If an independent regulator in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may remain a key audit partner for more than seven years, in accordance with such regulation, provided that the independent regulator has specified alternative safeguards which are applied, such as a regular independent external review." | | |
| | Q5. Does your jurisdiction have any additional or different local exceptions or special conditions for the application of audit partner rotation requirements for small firms and/or small entities? If yes, please provide details and any information that would be helpful for understanding the rationale for having these exceptions or conditions | [YES / NO] |
| | | |

Q6 IESBA CODE LONG ASSOCIATION PROVISIONS - ALL AUDIT CLIENTS (General provisions)

290.150 provides: "Familiarity and self-interest threats are created by using the same senior personnel on an audit engagement over a long period of time." The rest of this paragraph requires the significance of the threats to be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level.

Q6. In addition to, or instead of, rotation requirements (see Q1 above), does your jurisdiction have any additional requirements in relation to other senior personnel on an engagement?

[YES / NO]

If **yes**, please provide details and any information that would be helpful for understanding the rationale for having these requirements.

Q7 Q7. Are you are aware of any impending changes in audit partner rotation requirements in your jurisdiction?

[YES / NO]

If **yes**, please provide details and any information that would be helpful for understanding emerging requirements for audit partner rotation in your jurisdiction.

APPENDIX 2

Outline Draft Survey of Audit Committees

1. Do you believe that the threat to independence increases as a result of long association with the audit engagement by the audit engagement partner and other partners on the audit?

- Yes
- No

Comments:

2. Do you think rotation of the audit partners is necessary and appropriate to reduce the familiarity threat to independence?

- Yes
- No

3. Please indicate which partners² you think should rotate and after how many years rotation should be required for those partners.

| Number of years | No rotation | 3 | 4 | 5 | 6 | 7 | Other |
|-------------------------------|--------------------|----------|----------|----------|----------|----------|--------------|
| Lead audit engagement partner | | | | | | | |
| ECQR partner | | | | | | | |
| Other key audit partners | | | | | | | |
| Other(s), please describe | | | | | | | |

4. Please comment on your rationale for your answers to question 3.

5. Once rotated off, how long do you think the partner should be “off” the audit engagement?

| Number of years | 1 | 2 | 3 | 4 | 5 | Other |
|-------------------------------|----------|----------|----------|----------|----------|--------------|
| Lead audit engagement partner | | | | | | |
| ECQR partner | | | | | | |
| Other key audit partners | | | | | | |
| Other(s), please describe | | | | | | |

6. Please comment on your rationale for question 5.

² Definitions will be inserted

7. Do you think a partner who has rotated off the engagement should have any ongoing relationship with the client entity while rotated off?

- Should have no relationship at all
- Could act as a non-audit service partner
- Could act as a client relationship partner
- Other, please describe

8. On a scale of 1 (very unimportant) to 5 (very important), how important is partner rotation in assessing the independence of the auditor?

| Very unimportant 1 | 2 | 3 | 4 | Very important 5 |
|-----------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| <input type="radio"/> |

9. Do you think there should be any exceptions to the requirement to rotate?

- Yes, please explain
- No, please explain

10. Do you have any views on whether there is an impact on audit quality in the immediate period following rotation of key audit partners?

- Yes, please explain
- No, please explain

11. Only partners are currently required to rotate under the Code. Do you think other senior staff on the engagement should be subject to rotation?

- Yes, please explain
- No, please explain

12. What type of entities do you think rotation should apply to?

- Listed
- Other Public Interest Entities
- Other, please describe

13. Do you think that “those charged with governance” should be involved in the rotation decision and if so how and to what extent?

- Yes, please explain
- No, please explain

14. Are you a member on an audit committee?

- Yes
- No

15. Which best describes the organization(s) you serve?

- Listed
- Unlisted
- SME

16. In which region of the world are you located? [Insert standard drop-down list of countries]

APPENDIX 3

Extract from IESBA Code: Long Association of Senior Personnel (Including Partner Rotation) with an Audit Client

General Provisions

290.150 Familiarity and self-interest threats are created by using the same senior personnel on an audit engagement over a long period of time. The significance of the threats will depend on factors such as:

- How long the individual has been a member of the audit team;
- The role of the individual on the audit team;
- The structure of the firm;
- The nature of the audit engagement;
- Whether the client's management team has changed; and
- Whether the nature or complexity of the client's accounting and reporting issues has changed.

The significance of the threats shall be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such safeguards include:

- Rotating the senior personnel off the audit team;
- Having a professional accountant who was not a member of the audit team review the work of the senior personnel; or
- Regular independent internal or external quality reviews of the engagement.

Audit Clients that are Public Interest Entities

290.151 In respect of an audit of a public interest entity, an individual shall not be a key audit partner for more than seven years. After such time, the individual shall not be a member of the engagement team or be a key audit partner for the client for two years. During that period, the individual shall not participate in the audit of the entity, provide quality control for the engagement, consult with the engagement team or the client regarding technical or industry-specific issues, transactions or events or otherwise directly influence the outcome of the engagement.

290.152 Despite paragraph 290.151, key audit partners whose continuity is especially important to audit quality may, in rare cases due to unforeseen circumstances outside the firm's control, be permitted an additional year on the audit team as long as the threat to independence can be eliminated or reduced to an acceptable level by applying safeguards. For example, a key audit partner may remain on the audit team for up to one additional year in circumstances where, due to unforeseen events, a required rotation was not possible, as might be the case due to serious illness of the intended engagement partner.

290.153 The long association of other partners with an audit client that is a public interest entity creates familiarity and self-interest threats. The significance of the threats will depend on factors such as:

- How long any such partner has been associated with the audit client;
- The role, if any, of the individual on the audit team; and
- The nature, frequency and extent of the individual's interactions with the client's management or those charged with governance.

The significance of the threats shall be evaluated and safeguards applied when necessary to eliminate the threats or reduce them to an acceptable level. Examples of such safeguards include:

- Rotating the partner off the audit team or otherwise ending the partner's association with the audit client; or
- Regular independent internal or external quality reviews of the engagement.

290.154 When an audit client becomes a public interest entity, the length of time the individual has served the audit client as a key audit partner before the client becomes a public interest entity shall be taken into account in determining the timing of the rotation. If the individual has served the audit client as a key audit partner for five years or less when the client becomes a public interest entity, the number of years the individual may continue to serve the client in that capacity before rotating off the engagement is seven years less the number of years already served. If the individual has served the audit client as a key audit partner for six or more years when the client becomes a public interest entity, the partner may continue to serve in that capacity for a maximum of two additional years before rotating off the engagement.

290.155 When a firm has only a few people with the necessary knowledge and experience to serve as a key audit partner on the audit of a public interest entity, rotation of key audit partners may not be an available safeguard. If an independent regulator in the relevant jurisdiction has provided an exemption from partner rotation in such circumstances, an individual may remain a key audit partner for more than seven years, in accordance with such regulation, provided that the independent regulator has specified alternative safeguards which are applied, such as a regular independent external review.